SD Publication Series
Office of Sustainable Development
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Comparative Analysis of Economic Reform and Structural Adjustment Programs in Eastern Africa

With Emphasis on Trade Policies

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Technical Paper No. 19
June 1996

** A Joint Publication of AFR/SD and REDSO/ESA*

USAID

This publication is part of the

Regional Trade Agenda Series

USAID / Africa Bureau

Office of Sustainable Development
Productive Sector Growth and Environment Division
Food Security and Productivity Unit
and
Regional Economic Development Support Office
Eastern and Southern Africa, Office of Agriculture and Natural Resources

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U.S. Agency for International Development

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Project CA No.: 623-0478-00-3180-00

June 1996

Publication services provided by **AMEX International, Inc.**
pursuant to the following USAID contract:

Project Title:	Policy, Analysis, Research, and Technical Support Project
Project Number:	698-0478
Contract Number:	AOT-0478-C-00-3168-00

USAID

Contents

Foreword

Since the early 1980s, a number of countries in East Africa have been implementing economic reform and structural adjust programs in order to address issues of declining agricultural output, limited commercial import capacity, and stagnating economic growth. These reforms were proposed and supported by International Financial Institutions (IFIs) such as the World Bank, African Development Bank (ADB), and International Monetary Fund as conditionality requirements for obtaining structural adjustment loans.

Although progress made in these reforms has not been uniform across sectors and among countries, they were pursued with determination and have yielded some significant benefits in a few countries. Fiscal deficits have been reduced, inflation moderated and the exchange rates in many cases made more realistic.

Prices of farm products have become more attractive than before, and the liberalization of agricultural markets has improved incentives. But much remains to be done, among other things, in improving trade policy, restructuring public enterprises and reorganizing the financial sector. Many countries in East Africa continue to suffer a deterioration in their international terms of trade and severe declines in living standards.

Although they date as far back as 1919 with the formation of the East African Community (EAC), regional integration and trading schemes have not been successful in East Africa. However, countries have not been deterred from participating in them. In recent years, various East African countries have expressed a renewed interest to pursue regional integration. With this spirit, leaders of six East African countries and others outside the region formed the Cross Border Initiative (CBI) in August 1993. CBI's goal is to expedite and consolidate economic integration in Africa and create the Common Market for Eastern and Southern Africa (COMESA), a regional integration grouping which replaced the Preferential Trade Area for Eastern and Southern Africa (PTA). Since the promotion of trade has emerged as one of the primary economic goals for many countries in East Africa, trade policy is one area in which most, if not all East African countries have begun converging towards more liberal regimes. Most have liberalized their import regimes by lowering tariffs, reducing tariff dispersion, and reducing/eliminating quantitative restrictions.

Import licenses have been eliminated; most countries maintain little or no export restrictions, and do not levy export taxes. Most Governments have established free trade zones, instituted export incentives, offered tax and duty exemptions, and relaxed foreign investment restrictions. Public enterprise reforms have been the most difficult to implement.

In view of the potential implications of structural adjustment and economic reform programs for subregional and regional trade, food security, and overall economic growth and stability, this study is a step in the direction of informing Governments in the region and the international community of the status and future of economic reforms, especially trade policy reforms and how they all relate to national and regional development. The low levels of recorded intra regional trade that are noted by the study exemplify an existing trend in other regions of sub-Saharan Africa and are largely explained by restrictive trade policies of the past. The renewed political spirit supporting regional economic integration that Mr. Ngeno alludes and his survey of existing and emerging trade schemes is testimony to the increasing realization by East African leaders of the potential rewards of regional economic groupings, as was called for by the 1980 Lagos Plan of Action for the Development of Africa.

Partly because of its comparative nature, but also due to its focus on trade policies, the report goes beyond several institutional efforts to review and evaluate the economic reform and structural adjustment programs in East Africa in particular and sub-Saharan Africa in general.

This report is one in a series of studies on Africa's regional trade and agricultural comparative advantage, a joint activity of the USAID Africa Bureau's Food Security and Productivity Unit in the Office of Sustainable Development, Productive Sector Growth and Environment Division (AFR/SD/PSGE), and the Regional Economic Development Services Office for East and Southern Africa (REDSO/ESA).

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Executive Summary

This study analyses the current and future status of the implementation of key policy, regulatory, and institutional reforms in six East African countries. The policy reforms analyzed include fiscal, monetary, trade, public enterprises, investments, and price, and market liberalization. The countries covered by the study are Burundi, Ethiopia, Kenya, Rwanda, Tanzania, and Uganda.

These countries experienced economic stagnation in the 1980s as a result of worldwide recession, depressed commodity prices, social, and political instability and poor economic management. These countries have also faced severe macroeconomic instability and structural imbalances since the early 1980s. The economies of these countries are quite similar. With per capita gross national product of less than US$350, they are all ranked among the poorest countries in the world with Tanzania, Ethiopia, and Uganda ranked as the second, third, and fourth poorest in 1991 respectively. High population growth rates contribute to the low per capita incomes.

Attempts have been made to rejuvenate these economies through the implementation of stabilization and structural adjustment reforms. The reforms have been implemented with multilateral and bilateral donor support, especially from the International Monetary Fund and the World Bank. These are the policies analyzed in this study. The status of current policy implementation is assessed against the measures agreed upon between the countries and the donors. Future policy reforms are evaluated on the basis of their comprehensiveness and realism. Those policies that approximate best practice and appear realistic on the basis of past policy performance get top marks.

The study finds that public enterprise reforms have been the most difficult to implement. Only Kenya and Uganda have made some progress in the implementation of these reforms. Burundi, Tanzania, and Ethiopia have marginally implemented the reforms but Rwanda has made no effort at all. Technical difficulties and the nonviability of the enterprises has delayed implementation of these reforms.

The most successfully implemented policies have been trade and price and market liberalization. Trade liberalization is almost complete in all the countries except Rwanda and Ethiopia. Relaxation of import controls and export promotion have generally been fully implemented. Tariff reforms are still lagging behind in Rwanda, Uganda, Kenya, and Ethiopia; the same applies for exchange rate reforms in Rwanda, Burundi, and Ethiopia. The targets for price and market liberalization have been met in all the countries except Burundi and Ethiopia.

Investment policies have been moderately implemented. These policies have been, or are close to being, fully implemented in Uganda, Kenya, and Tanzania, but are at the early stages of implementation in Ethiopia and have not been implemented in Rwanda and Burundi.

All the countries, except Rwanda and Burundi, have made good progress in fiscal reforms. Nevertheless, no country has successfully implemented all planned reforms. The targets for deficit reduction were met in Uganda, Tanzania, and Ethiopia but failed to be met in the other countries. Tax reform targets were only met in Kenya and Tanzania and were barely implemented in Rwanda, Uganda, and Ethiopia. Budgetary reforms were poorly implemented in all the countries except Uganda.

Good progress has been made in the implementation of monetary policies in all the countries except Burundi. The implementation of some individual policies has been poor and patchy. Although, control of money supply has not been successful in Burundi, Uganda, Tanzania, and Kenya, targets have been fully met in Rwanda and Ethiopia. Interest rate reforms have been fully implemented in most of the countries. Uganda, Kenya, and Tanzania have fully met the targets for banking regulations. The implementation of bank reform policies are minimal in Rwanda and have not been made in Ethiopia. Monetary policies have not been implemented in Burundi.

On the whole, Kenya, Uganda, and Tanzania have the most articulated policy reforms. The reforms in these countries have also been mostly implemented. This performance is explained by the fact that policy reforms in these countries have been implemented over longer periods than in the other countries. Rwanda, Burundi, and Ethiopia are the poor reformers. This is primarily because of social and political instability in these countries. Ethiopia is a special case because before 1991 its economy was highly controlled, and reforms were only begun at the end of 1992.

Most of the countries have comprehensively articulated proposed future policy reforms. This is especially true of monetary, investment, price and market liberalization, and public enterprise policies. Trade policies have been comprehensively designed in Uganda, Kenya, and Tanzania, with Ethiopia only marginally behind. The design of these policies is, however, poor in Rwanda and Burundi. The least articulated reforms are fiscal policies. No country has comprehensively designed deficit reduction policies, and tax and budgetary reforms have only been comprehensively designed in a few countries.

At the country level Kenya, Uganda, and Tanzania have the most comprehensive policies, followed by Ethiopia and Burundi. Policy reforms are poorest in Rwanda where investment and market liberalization policies have not been stated. Even those policies that are to be implemented in Rwanda have not been clearly formulated. This is true of trade policy and public enterprise reforms. Only monetary policies and policies on price controls, subsidies and taxes have been well defined. This poor performance in Rwanda is a result of continued civil strife. Although social and political instability has also affected the reform program in Burundi the country has managed to design a more comprehensive reform program than Rwanda. This is especially true of investment and public enterprise reform. Fiscal deficits and budgetary control, together with interest rates and exchange rate policies, are the areas in which Burundi's reform program remains weak. Plans to implement tariff and price control policies have not been started.

For the better performers, Uganda and Kenya have the most comprehensive policies. All reforms, except fiscal policies have been comprehensively designed in these countries. Fiscal reforms, interest rate policy, and privatization policies have not been well articulated in Tanzania. Policy reforms in Ethiopia are at their infancy. This is especially true of fiscal, trade, and public enterprise policies. Considering that Ethiopia only started reforms in 1992, the comprehensiveness with which policies have been designed is remarkable.

The study established that recorded trade among the countries of Eastern Africa is very low. Kenya's exports to the region are the highest at only 13 percent of total exports. Rwanda and Uganda source about 22 and 23 percent respectively of their total imports from the region. Imports from the region by other countries make up less than 5 percent of their total imports.

The low levels of recorded intra-regional trade can be attributed to restrictive trade policies, especially high trade taxes, foreign exchange, and import controls. These policies reduce cross-border trade in the region by placing barriers to trade and by reducing the incentives to trade. They also distort the level of recorded trade by encouraging trade to go through unofficial channels, such as smuggling, therefore causing under reporting of total intra-regional trade. Foreign exchange controls also contribute to the distortion of recorded trade by encouraging overinvoicing of imports and underinvoicing of exports as a means of exporting capital. Trade liberalization will therefore not only raise recorded intra-regional trade through improved incentives and removal of obstacles to trade, but also by removing incentives to engage in smuggling. Liberalization also reduces transaction costs of foreign trade, leading to lower costs of imported goods, improving consumer welfare.

The study also reviews several regional integration schemes. The review concentrates on the objectives, achievements and prospects of the integration schemes. It finds that most of the integration schemes have failed to meet their objectives. The major reason is unequal distribution of benefits. The schemes have also failed to increase intra-regional trade as a result of the competitiveness in production among the partners and the failure to liberalize intra-regional trade.

The study concludes that regional integration based on unilateral trade liberalization (UTL) by each member of the region is the most appropriate form of regional cooperation. This type of arrangement is likely to succeed where the old regionalism failed because it encourages competition, increasing efficiency in production within the region. This will lower the costs of production and promote intra-regional trade and trade between the region and the rest of the world.

The removal of quantitative restrictions to trade and the movement toward convertible currencies will directly promote intra-regional trade. The policies will also remove incentives for smuggling and other illegal activities and raise recorded trade. UTL will also promote macroeconomic stability that improves credibility of government policies and encourages higher investment in the region. The most important aspect of the new regionalism, however, is that by emphasizing unilateral economic policies the polarization effects are neutralized, which caused breakdowns in regional integration schemes in the past. Each country will be forced to confront the consequences of economic reforms since there will be no scapegoats.

Glossary of Acronyms and Abbreviations

CEPGL	Economic Community of the Great Lakes Countries
COMESA	Common Market for Eastern and Southern Africa
EERP	Emergency Reconstruction and Recovery Project of the World Bank
EAC	East African Community
ERP	Economic Recovery Program
ESAF	Enhanced Structural Adjustment Facility
GDP	Gross Domestic Product
GNP	Gross National Product
GOK	Government of Kenya
IDA	International Development Agency
IMF	International Monetary Fund
KNTC	Kenya National Trading Company
KPCU	Kenya Planters Cooperative Union
OGIL	Open General Import License
PTA	Preferential Trade Area
SAC	Structural Adjustment Credit
SAF	Structural Adjustment Facility
SAL	Structural Adjustment Loan
SDR	Special Drawing Rights
TGE	Transitional Government of Ethiopia
TIN	Taxpayer Identification Number
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
URA	Uganda Revenue Authority
USAID	Unites States Agency for International Development
UTL	Unilateral Trade Liberalization
UTO	Unilateral Trade Organization
VAT	Value Added Tax

1. Comparative Analysis of Economic Reform and Structural Adjustment Programs in East Africa

INTRODUCTION

This study analyses the current status of implementation of key policy, regulatory and institutional reforms in Eastern African countries. Reforms bearing on macroeconomic management, trade, investments, labor, and price and market controls are emphasized. The countries covered are Burundi, Ethiopia, Kenya, Rwanda, Tanzania and Uganda.

A detailed analysis of implementation of stabilization and structural adjustment programs in each country is provided. The current status of policy implementation is assessed against measures agreed upon with the donors especially the International Monetary Fund (IMF) and the World Bank. A methodology is also developed and used to rank the extent of reform implementation by the countries under study. The ranking allows for comparative analysis of current trade and economic liberalization reform programs.

The study also outlines reforms which are scheduled to be implemented in 1994 and 1995. These reforms are ranked across countries on the basis of their depth and comprehensiveness. These results are used to distinguish good from poor reformers.

The source of the information used in the study are the policy framework papers and the IMF and World Bank Staff reports. These reports cover Structural Adjustment Facility (SAF), Enhanced Structural Adjustment Facility (ESAF), and Structural Adjustment Loan or Credit agreements between the countries under study and the IMF and World Bank.

The study also reviews existing trade agreements and trade flows among the countries of East Africa. The role of trade policies in the promotion of regional trade is analyzed. This is done through a comparative analysis of trade liberalization in the region. Economic cooperation among the Eastern African countries is also reviewed to assess how the arrangements can contribute to intra-regional trade.

The documents which have been used in this study are presented in the bibliography. Most of these documents were obtained from the U. S. Agency for International Development, Regional Economic Development Support Office, East Africa located in Nairobi, Kenya (USAID/REDSO/ESA).

BACKGROUND

The countries analyzed in this study vary greatly in size, from the relatively small Burundi with a population of less than six million to Ethiopia with a population of 53 million (Table 1.1). However, in 1991, all six countries were ranked amongst the poorest countries in the world with Tanzania, Ethiopia and Uganda ranked as second, third and fourth poorest in the world. Kenya, Rwanda and Burundi fare only marginally better with per capita GNP less than $350 (Table 1.1). All the six countries experienced poor economic performance between 1980 and 1991 with GNP per capita stagnating or declining in all the countries except Burundi which managed an average growth rate of 1.3 percent per year during the period.

One of the reasons for the slow growth in per capita GNP in these countries is the high population growth rate. Between 1980 and 1991 all the countries had annual population growth rates above 2.5% with Kenya having an exceptionally high rate of 3.8 percent (Table 1.1). The reasons for the poor economic performance are both internal and external. External factors include worldwide recession and depressed commodity prices, while internal factors include drought, civil strife and poor economic management. Table 1.1 shows that, excluding Kenya, the

Table 1.1 Basic Indicators (1991)

Table 1.2 Structure and Growth in Production

countries have not been able to mobilize significant domestic savings. It is also evident that Tanzania and Uganda have had severe inflation problems.

Apart from Kenya and Rwanda, the agricultural sector is dominant in the region, providing more than half of the total GDP (47 percent in Ethiopia) in 1991 (Table 1.2). In all the six countries the industrial sector is small, contributing less than 20 percent of GDP. The exceptions again are Kenya and Rwanda where the sector contributes 22 percent of GDP. This is below the Sub-Saharan Africa average of 29 percent of GDP. The contribution of the manufacturing sub-sector is highest in Rwanda where it constitutes 20 percent of GDP.

Despite its dominant position the agricultural sector performed poorly between 1980 and 1991, achieving a lower annual growth rate than the other sectors in all the countries except Tanzania. In the other countries the fastest growing sectors have been the services and manufacturing sectors (Table 1.2). The agricultural sector has performed particularly poorly in Ethiopia and Rwanda.

The external sector of Burundi achieved the best performance of the six countries between 1980 and 1991. The country managed to achieve an annual exports growth rate of 8.6 percent despite a large deterioration in the terms of trade since 1985. By 1991 Burundi had a stable reserve position with gross official reserves covering five months of imports (Table 1.3). In the other five countries exports grew by less than 3 percent per year with Tanzania experiencing a decline of almost 2 percent annually. Like Burundi, all the other countries suffered a decline in their commodity terms of trade with Uganda being the worst affected. Kenya's official reserves in 1991 could not even cover 3 weeks of imports and Ethiopia, Tanzania and Uganda did not fare much better.

Out of the six countries, only Rwanda is classified as a moderately indebted country by the World Bank. The other six countries are severely indebted. Table 3 shows that in 1991 Uganda's external debt was equal to its GNP while in Tanzania it was two and a half times the GNP. Kenya and Burundi also have large debt relative to GNP. In terms of debt service Uganda is in a tenuous position with interest and principal repayments equal to 70 per cent of export receipts. Kenya and Burundi also have debt service ratios above the 30 percent bench mark.

Overall, though Kenya had the highest GNP per capita in 1991, the best performing economy between 1980 and 1991 was Burundi which achieved significant growth rates in all sectors. Kenya also performed relatively well, but the slow expansion of exports meant economic growth could only barely keep up with the high population growth rate. On the other hand, Ethiopia, Tanzania and Uganda performed poorly by all measures with perhaps Tanzania performing the worst of all.

Table 1.3 External Indicators

2. Current and Future Status of Implementation of Policy Reforms

INTRODUCTION

This section reviews progress on program implementation by the countries under study. The purpose is to provide a consistent and systematic review of the reforms across all the countries. Current and future policies including program targets are reviewed.

Current policy reforms are those implemented between 1990 and 1993. However, for most countries the most current policies were implemented during 1991/92. The evaluation of current policy reforms is done by comparing program targets with actual outcomes from policy changes.

Future policy reforms are those to be implemented in 1994/95. Some countries, however, have programs running up to 1997. In many cases the latest available policy documents are for earlier years. In such cases the review covers the latest years for which information is available. Future policy programs are reviewed in terms of their comprehensiveness and the extent to which they can be implemented.

The policy reforms to be evaluated are classified into fiscal, monetary, trade, investment, price and market controls and public enterprise reform. Under each of these policies are specific policy, regulatory and institutional reforms. For example, fiscal policy reforms, cover budget deficit reduction, tax reform and budgetary reforms. Public enterprise reform has privatization and restructuring as its major policies.

Monetary policies cover control of money supply, maintenance of positive interest rates and bank regulation, while trade policies are: exchange rates, quantitative restrictions, tariffs and export incentives. Investment policies cover investment incentives and policies promoting and or restricting regional investments. Price and market liberalization policies cover decontrol of general prices, reduction or elimination of subsidies and market decontrols such as relaxation of controls on marketing of certain producer and consumer goods.

CURRENT POLICY REFORM IMPLEMENTATION

Fiscal Policy

The policy objective on the overall budget deficit in all the countries, was to reduce the deficit as a percentage of GDP (Table 2.1). In 1991, deficits as a percentage of GDP were programmed at 9.3 percent in Rwanda, 9 percent in Burundi and 6 percent in Tanzania. Deficits were programmed to be 8.1 percent in Kenya and 12.4 percent in Ethiopia during 1992/93. Program targets were met in Tanzania but were not met in Rwanda, Burundi and Kenya. The deficit was estimated to have been below target in Ethiopia while in Uganda the deficit was Uganda shillings 64 million below target at the end of June 1993.

Tax policy reforms involved changes in the tax system, for example widening the tax base, improved tax efficiency, tax rationalization and the introduction of Value Added Tax. A specific target was to increase tax revenue as a percentage of GDP. Tax reforms were implemented in all the countries, but at varying degrees. The reforms led to increased revenue in Tanzania and Kenya but program targets were not met in Rwanda and Uganda. Rationalization of taxes was the major tax effort in Ethiopia. However efforts to raise import taxes during 1991/92 were not successful.

The budgetary reforms which were introduced in the countries under study included reduction in expenditure as a percentage of GDP and civil service reform especially through reductions in public sector employment. All the countries, except Ethiopia, had civil service reform programs. However, only Uganda had a successful program while Kenya and Tanzania made some progress. Rwanda had made little progress in the reform. Public expenditure was under control in Uganda (1993), Tanzania (1991/92) and Kenya (1993).

Existing evidence indicates that pubic expenditure is currently (1994) out of control in Tanzania. Budgetary targets were not met in Rwanda. Ethiopia is unique in the sense that the policy was to raise public expenditure to stimulate growth and alleviate poverty. Even then, the current and capital expenditures were below program targets.

Monetary Policy

Targets for growth in money supply were 7.3 percent for Rwanda in 1992, 21 percent for Uganda in 1992/93, 13 percent for Tanzania in 1991/92 and 19.6 percent for Ethiopia in 1992/93 (Table 2.2). Money supply was programmed to grow by less than growth of GDP in Burundi in 1991. The money supply targets were only met in Rwanda and Ethiopia. The targets were exceeded by wide margins in Tanzania and Uganda. Excess money supply began to be contained in Kenya by March 1993.

The interest rate policy in most countries was to establish flexible and positive rates and to achieve full liberalization. Interest rates have been fully liberalized in Kenya and Uganda, while Rwanda has a flexible regime with positive real interest rates. Interest rates are still controlled in Tanzania and Ethiopia but the rates are largely positive in real terms.

Banking policies include improved supervision of commercial banks by the central banks, restructuring of state owned banks and financial institutions, and greater autonomy for central banks. The supervisory roles of the central bank were improved and commercial banks were restructured in Kenya, Tanzania and Uganda. The central bank failed to control the expansion of commercial bank credit in Rwanda.

Trade Policy

Exchange rate policies in the countries under study included the maintenance of a flexible regime through periodic devaluations, the pegging of currency to a trade-weighted basket of currencies and establishment of a dual exchange regime to one of unifying the rates (Table 2.3). The rates had been unified in Kenya, Tanzania and Uganda by the end of 1993. Burundi pegged its currency to a trade-weighted basket of currencies in 1992 and Rwanda has periodically devalued its currency. Ethiopia also devalued its currency in 1992 and 1993 but the premium between the official rate and the black market rate is still high.

All the countries, except Ethiopia, had an Open General License (OGL) system with a short negative list of restricted imports. Imports of beer, soft drinks and cigarettes remained banned in Uganda for purposes of protection. Import licensing was abolished in Kenya in May 1993; and import liberalization was initiated in Ethiopia in 1992/93.

Tariff policy encompassed reduction of the level of tariff rates and tariff rationalization including reduction in tariff dispersion and the number of tariff rates. All the countries have tariff reform programs in place. It is however evident that Tanzania has had the most successful reform. The maximum rate and the number of rates in Tanzania have been reduced to 40 percent and 4 respectively. The maximum tariff and number of rates in Kenya, Burundi, Rwanda and Uganda range from 50 percent - 100 percent and 5 - 8 respectively. Tariff reforms in Ethiopia were initiated in 1992/93.

Export promotion policies emphasize export incentives such as export retention schemes, duty drawback schemes, and reduction of export restrictions such as taxes and export licensing. Burundi, Kenya, Ethiopia, Uganda and Tanzania have duty drawback schemes.

Export retention schemes, allowing exporters to retain 30 percent to 50 percent of their export earnings, exist in Burundi, Kenya, Tanzania and Uganda.

Taxes on exports have (at least for non-coffee exports) been reduced or eliminated in most countries. Uganda imposed taxes on non-coffee exports. Other export incentives were limited in Tanzania and Rwanda. Export licensing had been liberalized in most of the countries.

Investments

Most countries had investment promotion policies in place (Table 2.4). In Burundi commercial and labor codes were drawn up in 1991/92. An investment code has been published in Uganda and investment licensing procedures have been simplified in Kenya.

In Tanzania, company taxes were reduced from 50 percent to 35 percent by 1992 and the Investment Act has been reviewed to simplify industrial licensing and registration. Barriers to entry and exit were removed through a new Investment Act in Ethiopia in 1992/93 and the top marginal rates of corporate tax were reduced.

Foreign investment promotion was carried out through reduction of taxes on foreign companies from 55 percent to 40 percent in Tanzania in 1992, and through the simplification of licensing procedures and relaxation of restrictions on profit repatriation and remittances in Kenya.

New laws were enacted in Ethiopia in 1992/93 which allowed domestic firms to enter into joint ventures with foreign firms. Restrictions on profit repatriation and remittances were also removed. Foreign investment is promoted in Uganda by the regulations laid out in the investment code. Foreign investment policies for Rwanda and Burundi were not available.

Price and Market Liberalization

Prices had been decontrolled in all the countries by the end of 1993 (Table 2.5). Retail and ex-factory prices were decontrolled in Ethiopia in 1992. Subsidies have also been eliminated in most countries.

Market liberalization was done in most countries through relaxation of controls in the labor market and removal of public sector monopolies in commodity trade, for example, through the abolition of monopoly marketing boards and the removal of controls on profits. The domestic markets of all the countries had been liberalized by the end of 1993.

Public Enterprises

Restructuring of public enterprises is being implemented in all the countries (Table 2.6). However, the process has been slow in Burundi and Tanzania while no progress has been made in Rwanda. Kenya and Uganda have made some progress with the establishment of reform secretariats and the liquidation and restructuring of several enterprises. The reform program was started in Ethiopia towards the end of 1992. A few enterprises have since been abolished.

Privatization has been slow in all the countries. No progress has been made in Ethiopia, Rwanda and Tanzania and no more than 10 enterprises have been privatized in Burundi and Uganda. Twelve enterprises have been privatized in Kenya.

FUTURE POLICY REFORMS

Fiscal Policy

Reduction of overall fiscal deficit is a target for all the countries (Table 2.7). The targets, however, vary across the countries. The target for Rwanda is 11.5 percent of GDP in 1993 and 7.5 percent for Burundi in 1995, 11.6 percent for Uganda in 1993/94, 6 percent for Tanzania in 1994/95, 9.7 percent for Ethiopia in 1993/94 and 1.8 percent and zero percent for Kenya in 1994/95 and 1995/96 respectively. The targets for Kenya appear too low and unrealistic and are unlikely to be achieved. Those for the other countries on the other hand are too high. However, continued civil strife in Rwanda and Burundi implies that the targets are likely to be exceeded in the short to medium term.

Tax reform programs in all the countries emphasize improvement in tax administration and increased efficiency with the objective of raising revenue. A Value Added Tax is to be introduced in Burundi, Uganda and Tanzania and the tax regime is to be shifted from production and trade taxes to consumption and income taxes in Rwanda.

Revenue is programmed to rise in 1993 to 13.3 percent of GDP in Rwanda, 0.5 percent in Uganda (1993/94) and 24 percent in Kenya (1995/96). This is to be achieved by raising indirect taxes on fuels, beer, cigarettes and drinks in Uganda and by removal of tax exemptions on public enterprises and extending VAT to services in Kenya.

Revenue is also to be raised in Kenya through the introduction of pre-shipment inspection of imports in January, 1994. Discretionary tax exemptions are to be eliminated in Tanzania by 1994/95. In Ethiopia, import exemptions and zero-rated tariffs are to be reduced and sales taxes are to be extended to services and rental income.

The major budgetary policy is the reduction in public expenditure through lower public expenditures on goods and services, civil service reform, introduction of cost sharing and cost recovery on health and education services, and by reduction of subsidies. Current expenditure is programmed to decline to 15.3 percent of GDP in Rwanda in 1993. In Tanzania, it is to be limited to an average of 24 percent of GDP between 1992 and 1995.

Total expenditure is programmed to fall in Kenya to 26 percent of GDP between 1994/95 and 1995/96. A public expenditure review is to be done in Ethiopia in 1993/94. Although public expenditure on salaries and wages is programmed to decline in Burundi, expenditure on goods and services is to increase to 28 percent of GDP in 1993 and 30 percent in 1994.

The civil service is to be reviewed as a prelude to civil service reform in Rwanda. Civil service reform is to be initiated in Burundi with the aid of the United Nations Development Program (UNDP). Fifty thousand civil servants are to be retrenched in Tanzania between 1992/93 and 1994/95 while 26,000 are to be retrenched in Kenya in 1993/94 with another 16,000 to be retrenched every year up to 1996/97. In Uganda, the civil service is to be reduced by 5,000 and 10,000 soldiers are to be demobilized by March 1994. Another 10,000 to 15,000 soldiers are to be demobilized in 1994/95. A review of the civil service including a census is to be completed in Ethiopia by the end of 1993.

Monetary Policy

Control of the growth of money supply is a major policy in all the countries (Table 2.8). Growth of money supply is to be kept below the growth of nominal GDP in Rwanda and Burundi. Liquidity growth compatible with desired GDP growth and macroeconomic variables is to be maintained in Kenya and Ethiopia. The growth of broad money is to be lowered to 14.7 percent in Uganda during 1993/94 and tight monetary policy is to be followed in Tanzania in 1992-95.

Interest rate policies vary marginally across the countries. Positive real interest rates are to be maintained in Ethiopia, Rwanda and Uganda. Liberalization of the interest rates was to be initiated in Rwanda and Uganda in 1993 and in 1995/96 in Ethiopia. Although positive rates are to be maintained in Burundi, no timetable for full liberalization is provided. This is also true for Tanzania. The policy in Kenya, which has fully liberalized interest rates, is to keep the rates positive during 1994/96.

Banking policy in many of the countries during the 1993-96 period is geared to improve the efficiency of the financial sector. The supervisory role of central banks is also to be improved. Financial sector reforms are to be implemented in Kenya, Rwanda and Uganda. The supervisory role of the central bank is to be improved in Ethiopia, Burundi and Uganda. Restructuring of commercial banks is to be continued in Kenya and Tanzania.

Trade Policy

Exchange rate policy in all countries is geared to achieve a competitive system (Table 2.9). However, there were no plans to fully liberalize the system in Rwanda in 1992. The exchange rate was to remain pegged to a basket of currencies in Burundi between 1992 and 1995. Tanzania was to move to a unified exchange rate in 1992 and a similar move was to be made in Ethiopia following an improvement of the foreign exchange system in 1993/94. The policy for Kenya (1994/96) and Uganda (1993/94) is to maintain a stable exchange rate through appropriate intervention in the interbank market.

Import liberalization is a major policy in most countries. Quantitative Restrictions are to be replaced by tariffs and tariff surcharges in Burundi. The few import bans in Uganda are to be removed during 1993/94 under the regional initiative to facilitate cross-border trade and investment. Import licensing procedures are to be simplified in Tanzania and the negative list of restricted goods is to be made short. Imports are to be liberalized in Ethiopia in 1994/95 through automatic licensing of imports and removal of legal and institutional restrictions on imports.

Tariff rationalization is the major tariff reform in most countries. Maximum tariffs and the number of tariffs are to be reduced in Rwanda by early 1993 and Ethiopia during 1994/95. Tariff rates are to be reduced from 0 - 50 percent to 0 - 30 percent in Uganda and the number of tariff rates are to be reduced from 6 to 4 in 1993/94. The maximum rate and the number of rates were reduced to 40 percent and 4 respectively in Tanzania by 1992/93. The 25 percent surcharges imposed on imports in Kenya in July 1993 are to be abolished by July 1994. The maximum tariff and the number of rates are to be reduced to 30 percent and 4 respectively by July 1997.

Exports, in the countries under study, are to be promoted by improved competitiveness, provision of incentives and relaxation of export restrictions. Devaluation and export diversification will be used to promote exports in Rwanda from 1993. In Burundi exports will be promoted between 1992 and 1995 through simplification of export controls and procedures and by the establishment of export processing zones with the aid of USAID. Export licensing and the duty drawback scheme are to be simplified in Tanzania before 1994/95.

Cotton and Tea sectors are to be liberalized in Uganda during 1993/94. The remaining export taxes are to be removed in Kenya by July 1994 and export licensing is to be abolished except for a short negative list. Export incentives are to be increased through expansion of the Duty/VAT remission scheme. Exports are to be promoted in Ethiopia in 1993/94 through a reduction in coffee license fees and by the broadening of the duty drawback scheme.

Investment

Investment is to be promoted in Burundi through improvements in tax incentives and by the enactment of company and commercial codes, bankruptcy laws and a labor law which is to be presented to the legislature by the end of 1993 (Table 2.10). Corporate tax is to be reduced from 35 percent to 30 percent in Uganda in 1993/94.

The Investment Act in Tanzania is to be reviewed by 1993 to simplify and reduce industrial licensing procedures. Investment is to be promoted in Kenya through policies which ensure macroeconomic stability and by reduction of fees and licenses required for new businesses. Restrictions on retail and wholesale trade are also to be reduced by July 1994. Investment is to be promoted in Ethiopia through changes in the law, especially commercial and investment codes, to encourage private sector participation in the economy.

Foreign investments are to be encouraged in Burundi through tax incentives, the establishment of a free trade zone and the liberalization of the current account by 1995. A similar policy is to be carried out in Tanzania by harmonizing company tax rate for resident and nonresident companies in 1993/94 and through the review of the Investment Act.

Foreign investment is to be encouraged in Kenya by changes in the Exchange control Act and by ensuring macroeconomic stability. In Ethiopia, approvals of foreign investments and joint ventures are to be improved in 1993/94. Foreign investment will be promoted in Uganda through reductions in corporate taxes and increased regional cooperation.

Price and Market Liberalization

Prices have been decontrolled in most of the countries (Table 2.11). Future reforms in this area therefore involve removal of the few remaining controls. Only Ethiopia has a relatively controlled price regime. Uganda and Tanzania, although indicating no future policies, have decontrolled prices. Subsidies have not been major policy instruments in the countries under study.

Policy reforms are therefore confined to reduction of subsidies on a few commodities, especially petroleum and public utilities. Prices of petroleum are to be increased to reflect economic cost in Uganda, Rwanda, Tanzania and Ethiopia. Water and electricity tariffs are to be adjusted in Burundi, during 1993/95, towards long run marginal costs.

Fertilizer subsidies are to be reduced in Tanzania to about 40 percent in 1992/93 and 20 percent in 1993/94 and thereafter. In Ethiopia cost sharing is to be introduced in social services. Subsidies to public enterprises are to be gradually reduced and eventually eliminated in Kenya by 1996/97. Subsidies to public monopolies will be eliminated through continuous tariff adjustments.

Market liberalization is a major component of structural adjustment in all the countries. Agricultural sector reforms especially decontrol of marketing of agriculture goods and supply of inputs are to be carried out in Tanzania (1992/93) and Uganda (1993/94). The reforms in Burundi include reduction of rigidities and constraints in the commercial sector and labor market, elimination of enforced cultivation of cotton and use of fertilizer in the tea industry, and the liberalization of the distribution of seed and fertilizers by 1995.

The labor market will be liberalized in Ethiopia between 1993/94 and 1995/96. Competition in the wholesale and retail trade will also be encouraged. The labor market will be liberalized in Kenya by July 1994 and the monopoly of trading companies such as KNTC and KPCU is to be eliminated by March 1993.

Public Enterprise Reforms

Public enterprise reform is a major concern in all the countries (Table 2.12). Burundi, Uganda, Tanzania and Kenya have developed comprehensive programs for the restructuring of public enterprises. The programs in Rwanda and Ethiopia are at their early stages.

Privatization is the other component of public enterprise reform. A strategy of privatization is at the early stages in Rwanda. In Uganda 8 out of 43 enterprises scheduled for privatization are to be privatized in 1993/94. Three hundred enterprises are to be privatized in Tanzania over a five year period. However, no schedule for the sales has been established except for those enterprises to be sold in 1991/92.

Public enterprises equivalent to 41 percent and 14 percent of total government assets are to be privatized in Burundi in 1993 and 1994 respectively. One hundred and ninety nonstrategic enterprises are scheduled for privatization in Kenya. Of these, 25 are to be brought to the point of sale by the end of 1994 and about 40 enterprises will be sold per year in 1995 and 1996. Nonstrategic public enterprises in Ethiopia including all retail shops, at least 29 hotels and restaurants, 90 state farms and 60 manufacturing enterprises will be privatized over a period of three years starting in 1993/94.

Table 2.1 Current Status of Policy Implementation: Fiscal Policy

Table 2.2 Current Status of Policy Implementation: Monetary Policy

Table 2.3 Current Status of Policy Implementation: Trade Policy

Table 2.4 Current Status of Policy Implementation: Investment

Table 2.5 Current Status of Policy Implementation: Price and Market Liberalization

Table 2.6 Current Status of Policy Implementation: Public Enterprises

Table 2.7 Future Policy Reforms: Fiscal Policy

Table 2.8 Future Policy Reforms: Monetary Policy

Table 2.9 Future Policy Reforms: Trade Policy

Table 2.10 Future Policy Reforms: Investment

Table 2.11 Future Policy Reforms: Price and Market Liberalization

Table 2.12 Future Policy Reforms: Public Enterprises

3. Analysis of Policy Reforms

INTRODUCTION

This study assesses the implementation of policy reforms in each country and compares performance across countries. The analysis compares policy pronouncements and evaluations contained in policy Framework Papers and or in IMF Staff Reports under Article IV Consultation. The extent of policy reform implementation is evaluated by comparing policy statements with actual outcomes of policy reforms. Where specific program targets are set the analysis examines whether the targets are met or not. The reform is then graded according to the extent of implementation and the extent to which program targets were met.

To assess current status of reforms marks ranging from 0 to 3 are assigned. A reform receives a mark of 3 if it is fully implemented and a mark of 0 if it is not implemented. A reform receives a mark of two if it is mostly implemented and a mark of 1 if it is marginally implemented. There is clearly an element of subjectivity with the last two grades. It is therefore necessary to clearly distinguish policies which are mostly implemented from those which are marginally implemented.

ANALYSIS OF CURRENT POLICY REFORMS

Introduction

The evaluation of current policy reforms is done using the information from the detailed discussions on policy reforms in section 3. This subsection confines itself to the grading of the policy reforms. Detailed justifications of the grades are given.

Fiscal Policy

It is evident (Tables 2.1 - 2.6) that half of the countries (Uganda, Tanzania and Ethiopia) fully met program targets on overall budget deficits and the other half (Rwanda, Burundi and Kenya) did not. Countries which met program targets got maximum points and the others obtained zero marks.

Tax reforms experienced mixed performance across countries. Major tax reforms, especially tax rationalization and improved administration, were carried out in Kenya and Tanzania. These reforms contributed to increased tax revenues in these countries and they were, therefore, assigned a grade of 3.

Tax reforms contributed to increased revenue in Burundi. However, the reforms were not extensive and therefore earned a grade of 2. Tax reforms were implemented in Rwanda and Uganda but revenues were below program targets and therefore they were assigned a grade of 1. A similar grade is awarded to Ethiopia for its attempt at introducing tax reform.

The performance of budgetary reforms was also mixed. Uganda was assigned a mark of 3 because total expenditure was below program target and public sector reform was advanced. Tanzania and Kenya obtained a grade of 2 because although public expenditure was under control, civil service reform has been slow. Budgetary targets were not met in Burundi and there was no progress in public sector reform in Rwanda.

Although current expenditure in Burundi was in surplus, public sector reforms had not been put into place. Ethiopia is unique because budgetary policy was expansionary. Even then the budget was below the program targets due to lower than expected external assistance. Public expenditure reform program had not been formulated. Ethiopia and Burundi therefore obtained a grade of 1, while Rwanda received zero.

Monetary Policy

Analysis of monetary policies shows that most countries achieved their program targets. However, only Ethiopia and Rwanda achieved money supply targets and were therefore awarded full marks. Money supply targets were exceeded in Burundi, Tanzania, Uganda and Kenya and therefore they were assigned a mark of zero. Uganda and Kenya have fully liberalized interest rates, while Rwanda has a flexible interest rate regime with positive real interest rates. Full marks were therefore awarded to these countries.

Ethiopia and Tanzania have made some progress in interest rate reform leading to positive rates. A mark of 2 was awarded to these countries for this effort. The documents reviewed did not contain any interest policy for Burundi. Bank regulation has been strengthened in Uganda, Kenya and Tanzania. Banks have been restructured, with some being liquidated, and the supervisory role of the central banks enhanced.

Top marks have, therefore, been awarded to these countries. Although central banks failed to control credit expansion in 1991 in Rwanda the money supply target was met in 1992. However, since bank regulation policy has not articulated, a mark of 1 was awarded. Little progress has been made on bank reforms in Ethiopia leading to an award of zero marks.

Trade Policy

Trade policies have been widely implemented in all the countries. The grading system used for exchange rate policy is that 3 was assigned where the exchange rate is unified and market determined, 2 where a dual exchange rate system exists but the currency is not overvalued, 1 where the rate adjusts but the currency is overvalued and zero where the exchange rate is controlled and overvalued. Uganda, Kenya and Tanzania got the maximum mark while the rest attained a mark of two.

All the countries, except Ethiopia, obtained a mark of 3 for quantitative restrictions because they had all established OGL systems with short negative lists of goods controlled for health and security reasons. However, Uganda had a list of three types of goods banned for protection. Little progress had been made in Ethiopia toward import liberalization thus a mark of 1 was awarded. This was because liberalization only began in 1992/93.

Grading of tariff reforms was a little complicated. The top grade was awarded if a country had rationalized tariffs with maximum rate of 50 percent or less and the number of tariffs being no more than 5. A grade of 2 was assigned where the maximum tariff rate was less than 100 percent and the number of rates were less than 10; and a grade of 1 was given where tariff reform exists and zero if there is no tariff reform. Burundi and Tanzania get top marks and Rwanda, Kenya and Uganda get 2 marks, while Ethiopia gets a mark of 1.

All countries, except Rwanda, get top marks for export promotion because they have implemented vigorous policies. Most of these countries have duty drawback and export retention schemes and have abolished export taxes. Rwanda has eliminated non-coffee export taxes but has no other incentives and is therefore assigned a mark of 1.

Investment Policies

Implementation of Investment policies has been problematic in many countries. A maximum grade was assigned to Kenya, Uganda and Tanzania for their policies in investment promotion. Licensing procedures have been simplified in Kenya while company taxes have been drastically lowered in Tanzania. An investment code has been adopted in Uganda and the Investment Act is also being reviewed in Tanzania with a view to simplifying licensing and registration procedures. An investment law was enacted in Ethiopia during 1992/93 to remove barriers to exit and entry and corporate taxes were also reduced. The country was awarded 2 marks for this effort.

Burundi was awarded 1 mark because progress toward implementation of investment promotion policies has been slow. Uganda was awarded 3 marks for policies to promote foreign investment through the investment code.

However, Kenya, Ethiopia and Tanzania were awarded 2 marks because although they have implemented a wide range of policies to attract foreign investment a lot remains to be done before a suitable environment for foreign investment is established. Information on foreign investment policies was not available for Rwanda and Burundi.

Price and Market Controls

Policies to liberalize prices and the market have received adequate attention in all the countries. Prices have been decontrolled in all countries, except Ethiopia. Most subsidies have also been removed in all the countries, except Ethiopia.

For these reasons the countries get maximum points while Ethiopia gets 2 points for the partial implementation of these polices. Domestic market liberalization has been achieved through removal of public sector monopoly in trade and the relaxation of controls in the labor market. This has been achieved in Rwanda, Uganda, Tanzania and Kenya which are therefore awarded 3 marks. Burundi and Ethiopia are awarded 2 marks because their markets are still relatively controlled.

Public Enterprises

Public enterprise reforms have been initiated in all the countries. Uganda and Kenya have made some, though not substantial, progress in the restructuring of the public enterprises and are awarded 2 marks. One mark is awarded to Burundi, Tanzania and Ethiopia because they have made only marginal progress in public enterprise restructuring. However, Rwanda has made very little progress in implementing this policy and therefore gets a mark of zero.

Privatization has also been poorly implemented. Rwanda, Tanzania and Ethiopia have made no progress in this area and therefore get zero marks. Burundi and Uganda are awarded 1 mark for their marginal performance while Kenya gets 2 marks for their better performance.

Summary of Reform Performance

Reform performance by policy and country are summarized in Table 3.1. The average performance of each country is obtained by dividing total points by the number of programs implemented. The average points should be used with care when comparing the extent of liberalization across countries. This is because the breath and intensity of economic reforms differ across countries. For example, reform programs in Ethiopia, although it has only begun the process of economic liberalization, have been implemented more comprehensively than in Rwanda and Burundi. Ethiopia should therefore be viewed as a better reformer than the other two countries even though they have equal average points.

Table 3.1 shows that Kenya, Uganda and Tanzania have comprehensively implemented policy reforms. These countries have the highest total and average points. The majority of reforms have also been fully implemented in these countries. The reform programs in these countries were initiated before or about the mid-1980s.

The success in policy reform in these countries is therefore partly explained by the long period within which the policies have been implemented. With the exception of fiscal and public enterprise reform policies, most policies have been implemented in Rwanda. However there is no information on the implementation of investment policies. Burundi, with 19 total points, is the poorest reformer.

Although reforms in Burundi started in 1986 most of the policies have not been comprehensively implemented and those which have been implemented have met with little success. This is primarily because of social and political instability. However, trade and public enterprise policies have been mostly implemented. Ethiopia is a special case in the sense that before 1991 the economy was highly controlled.

Table 3.1 Outcome of Reform Implementation in East African Countries

The first task of the Transitional Government of Ethiopia when it came to power was to restore order before embarking on structural reforms. The reforms were initiated at the end of 1992 under the 1992/93-1994/95 stabilization and structural adjustment program arrangement which became effective in October 1992. The Ethiopian reform program has mostly covered all the policies. The poor performance largely reflects the fact that the results represent less than one year of progress.

It is evident that fiscal policies have been among the most difficult to implement. Only Uganda and Tanzania have above average performance. In general, budgetary controls have been implemented in all the countries but Uganda is the only country to fully implement them. Tax reforms have also been implemented in all countries but have only been fully implemented in Kenya and Tanzania. Fiscal deficit targets were met in Uganda, Tanzania and Ethiopia but the other countries failed to meet them. External factors such as changes in the terms of trade and political instability account for the inability of the authorities to achieve the targets for the fiscal policy variables.

Public Enterprise reforms have been the least implemented. Although, the reforms have started in most of the countries no country has managed to fully implement any of the policies. Only Kenya and

Uganda have above average performance. In many instances the delay in these reforms has resulted from technical difficulties and non-viability of the enterprises.

Information on the implementation of investment policies is not available for Rwanda and Burundi. In Uganda, Kenya and Tanzania where information is available the policies have mostly been implemented. Implementation in Ethiopia has been below average.

The most successfully implemented reforms are trade and price and market liberalization policies. Trade reforms have been comprehensively implemented in almost all the countries. The exception is tariff reform which seems to be lagging behind in many of the countries. All the countries, except Burundi and Ethiopia, have fully implemented price and market liberalization policies. Moreover, Ethiopia, the most recent reformer, has an above average performance in this area. The performance of Burundi is blurred by the absence of information.

The implementation of monetary policies has been poor and patchy. The implementation has been average in Rwanda, Uganda and Kenya and below average in Tanzania and Ethiopia. Little information exists on the implementation of policy reforms in Burundi.

Control of money supply has not been successful in Burundi, Uganda, Tanzania and Kenya, but targets were fully met in Rwanda and Ethiopia. Interest rate reform has been successfully implemented in most of the countries. Banking regulation reform has only been fully implemented in Uganda, Tanzania and Kenya. Implementation of this policy is minimal or nonexistent in Rwanda and Ethiopia and there is no information on its implementation in Burundi.

FUTURE POLICY REFORM IMPLEMENTATION

Introduction

The analysis of future policy reforms is based on the summary discussions in Chapter 2, subsection "Future Policy Reforms," and Tables 2.7 - 2.12. The reforms are evaluated on the basis of their comprehensiveness and realism. Policies which are judged to approximate best practice are given high marks and vice versa.

Fiscal Policy

All the countries have programmed to reduce the ratio of overall deficit as a percentage of GDP. Rwanda and Uganda have planned to reduce the ratio to about 12 percent of GDP while Burundi, Tanzania and Ethiopia are to reduce the deficit to between 6 and 10 percent. These targets are too high. Kenya has programmed to reduce the deficit to 1.8 percent of GDP in 1994/95 and to eliminate it by 1995/96. These targets are unrealistic and past experience suggests that they are unlikely to be met. All the countries are therefore awarded 2 marks.

The tax systems are to be reviewed in all the countries. An ideal tax reform should increase the elasticity and efficiency of the tax system with the aim of raising revenue and minimizing domestic distortions. Rwanda, Uganda and Kenya have the most comprehensive tax reforms and therefore get the top marks. The revenue targets are 13.3 percent, 9.5 percent and 24 percent of GDP for Rwanda (1993), Uganda (1993/94) and Kenya (1995/96) respectively. Value Added Tax systems are to be introduced in Rwanda and Uganda and the system is to be extended to cover services in Kenya.

Tax administration is also to be improved in the remaining countries. This includes the introduction of a Value Added Tax system in Tanzania and Burundi and the extension of sales tax to cover services and rental income in Ethiopia. However, the reforms in Uganda, Tanzania and Ethiopia are not as deep as those of the other countries and are therefore awarded a mark of 2.

Budgetary reforms include reduction in public expenditure and civil service reform. Uganda, Tanzania and Kenya have the most comprehensive reforms. For example, public sector expenditures are programmed to decline to 24 percent of GDP between 1992 and 1995 in Tanzania. Expenditures are also targeted to decline to 26 percent of GDP between

1994 and 1996 in Kenya. Civil service reform is also at an advanced stage in all these three countries. These countries therefore earn 3 marks for the reforms. Public expenditure and civil service reforms are in early stages in Rwanda, Burundi and Ethiopia and therefore earn 2 marks.

Monetary Policy

All the countries have programmed to maintain the growth of money supply consistent with GDP growth and macroeconomic stability and therefore get top marks. Interest rate policy for all the countries is to keep the real rate positive. However, the pace of liberalization differs across countries. Kenya already has a fully liberalized interest rate regime and full liberalization is expected in Rwanda in 1993, Uganda in 1993/94 and Ethiopia in 1995/96.

Burundi and Tanzania do not have timetables for full liberalization and therefore get 2 marks, while the other countries get top marks. Financial sector reforms including restructuring of commercial banks and the strengthening of the supervisory and management capabilities of the central banks is to be undertaken in all the countries. Top marks are awarded to all the countries for this.

Trade Policy

All the countries have programmed to maintain a competitive exchange rate regime. Kenya already has a unified exchange rate while Uganda and Tanzania have established timetables to unify the rates by 1993. The timetables were not met in either country. The remaining countries have not set any time schedules for exchange rate unification and therefore, receive 2 marks.

The OGL system already exists in all the countries and therefore most future policies are aimed at the removal of existing restrictions on the list. Import licensing procedures are to be shortened in Tanzania by 1993. The remaining bans on a few import items are to be lifted in Uganda from 1993/94. Quantitative restrictions are to be replaced by tariffs and tariff surcharges in Rwanda by January 1993. Automatic import licensing and removal of legal and institutional barriers to imports are to be effected in Ethiopia in 1994/95.

For these reasons Tanzania and Uganda get 3 marks while Rwanda and Ethiopia get 2 marks. Burundi and Kenya have no policy statements on this issue but already have highly liberal import regimes and therefore get top marks.

Uganda, Kenya and Tanzania get top marks for tariff reforms. Uganda has programmed to reduce the maximum tariff to 30 percent and the number of tariffs to 4 in 1993/94 while Kenya has programmed to achieve the same target in 1997. Tanzania has already established a maximum tariff of 40 percent and the number of rates of 4. Tariff reforms are to continue in Rwanda and Ethiopia but specific targets are not provided. These two countries are therefore awarded 2 marks. Information on tariff reform in Burundi was not available.

All the countries, except Rwanda, have programmed to promote exports through an array of policies including removal or simplification of export licensing, duty drawback schemes, removal of export taxes, and export processing zones. They are therefore awarded top marks. Rwanda is to promote exports through devaluation and export diversification from 1993 and is therefore awarded 2 marks.

Investment

All the countries, except Rwanda, get top marks for investment promotion policies. These countries have programmed to promote exports through tax incentives, market liberalization, and the removal of legal and institutional barriers to investment. Rwanda has no policy statements. All the countries, except Rwanda, also get top marks on foreign investment policy. Foreign investment is to be encouraged in these countries through tax incentives, relaxation of exchange control regulations and the removal of legal and institutional barriers. There are no policy statements on foreign investment for Rwanda.

Price and Market Liberalization

Most countries get top marks on price policy because price controls have been removed. Although no policy statements are given for Uganda and Tanzania they get top marks because prior knowledge indicates that they have decontrolled prices. Price deregulation is a recent phenomena in Ethiopia. Future reforms are therefore less comprehensive and therefore the country gets 2 marks.

Reforms on removal of subsidies are well articulated in all the countries and are therefore awarded top marks. This also applies to market liberalization polices, except for Rwanda where no policy statements have been made.

Public Enterprise Reform

Burundi, Uganda, Tanzania and Kenya get top marks for their policies in restructuring public enterprises. These countries have clear and elaborate policies on rehabilitation or liquidation, and performance and management evaluation of public enterprises. Rwanda and Ethiopia get 2 marks because their restructuring policies are still at the early stages.

Future policies on privatization are mixed across countries. Burundi, Uganda, Kenya and Ethiopia get full marks for designing elaborate privatization programs. This includes specifying the number of firms to be privatized and specific timetables for privatization. The program for Rwanda and Tanzania are less articulate and therefore get 2 marks.

Summary of Future Policy Reform Implementation

Table 3.2 provides summaries for future policy reforms by the six Eastern African countries. As before the average performance of each country is estimated by dividing the total marks by the number of policies to be implemented. The average indicates the depth of policy reform. Total marks, on the other hand, can be used to asses the comprehensiveness of policy reforms

It is evident that policy reforms in Rwanda are not comprehensive. Investment policies have not been articulated at all. Even those policies which are to be implemented have not been clearly formulated as indicated by the low total points. This is true of trade policy and public enterprise reforms.

Only Monetary polices and policies on price controls, subsidies and taxes have been well defined. This shortcoming in Rwanda is mainly a result of continued civil strife. Social and political instability has also affected the reform program in Burundi. This country has managed to design a more comprehensive reform program than Rwanda. This is especially true of investment and public enterprise reform for which Burundi gets maximum points.

Fiscal deficits and budgetary control together with interest rates and exchange rate policies remain weak in Burundi’s reform program. The implementation of tariff and price control policies has not been stated.

Ethiopia, Uganda, Kenya and Tanzania have well defined policies. Uganda and Kenya however have the most comprehensive policies. They score maximum points in all reforms, except fiscal policies. Fiscal reforms, interest rate policy and privatization policies have not been well articulated in Tanzania. Policy reforms in Ethiopia are at their infancy. This is especially true of fiscal, trade and public enterprise policies. Considering that Ethiopia only started reforms in 1992, the comprehensiveness with which policies have been designed is remarkable.

Most policies have been comprehensively articulated. The exception being fiscal reforms in general. Reductions of fiscal deficits and budgetary controls are the least articulated policies. Tax reforms, and exchange rate policies are also not well articulated. These policies earn less than maximum points in more than half the countries.

Table 3.2 Ranking of Future Policy Reforms

4. Comparative Analysis of Trade Policies and Regional Agreements in East Africa

EFFECTS OF TRADE LIBERALIZATION ON REGIONAL TRADE

Trade policies, especially high trade taxes, exchange controls and import controls, play a major role in intra-regional trade. High tariffs and export taxes encourage smuggling and mis-invoicing of imports and exports, primarily as a means to evade taxes. This leads to understatement of recorded trade. Over-valued domestic currencies resulting from exchange controls, reduce export prices and therefore act as implicit taxes on exporters. This encourages smuggling, especially if the exports fetch higher prices in neighboring countries.

Foreign exchange controls contribute to distortions of recorded trade by encouraging over-invoicing of imports and under-invoicing of exports as a means of exporting flight capital. This overstates recorded imports and understates recorded exports. Import controls create shortages of imports which can only be satisfied through smuggling.

The smuggled goods in these circumstances are financed through foreign exchange obtained in the black markets. Smuggling has also been facilitated in the past by barter trade and by the semi-convertibility of currencies in border areas. Smuggling and other forms of illegal trade increases the transactions cost of foreign trade. These costs are passed on to the consumer through higher prices of imported goods.

The recent policy changes, especially trade liberalization and the movement toward market determined exchange rates in the region should increase intra-regional trade. These policy changes will reduce distortions on recorded trade by removing incentives to smuggle. Plans by the central banks of Kenya, Uganda and Tanzania to make their currencies convertible in the region, already started by allowing limited convertibility in border areas, will make cross-border trade efficient and less costly.

Tables 4.1 - 4.4 summarize current and planned trade policy reforms in the region. It is evident from comparing current and future reforms, that the policy design and implementation have improved over time. On average, most countries receive higher marks for future policies compared to current policies. However, the comprehensiveness of policy implementation still differ across countries. Policy reforms are more comprehensively designed and implemented in Uganda, Kenya and Tanzania than in Rwanda, Burundi and Ethiopia.

The implementation of current tariff reforms has been poor (Table 4.1). Only Burundi and Tanzania get maximum points. Tanzania has reduced the maximum tariff rate to 40 percent and the number of rates to 4. Uganda and Kenya plan to reduce the maximum rate to 30 percent and to reduce tariff dispersion by reducing the number of rates to 4. These policy changes should increase intra-regional trade by reducing the landed costs of imports and by reducing the need for smuggling. The future tariff reforms of Rwanda, Burundi and Ethiopia are below expectations.

Current implementation and future reform of exchange rate policies is poor in Rwanda, Burundi and Ethiopia (Table 4.2). The exchange rates are still controlled in Rwanda and are only adjusted through devaluation. The rates are pegged to a trade weighted basket of currencies in Burundi. Although the currency is adjusted by means of regular devaluations and through foreign exchange auctions in Ethiopia the difference between the official and parallel market rates is still high. The future plans are to move towards a market determined exchange rate. The exchange rates in Kenya, Uganda and Tanzania are now fully determined in the interbank markets. This

Table 4.1 Performance of Tariffs Reforms

Table 4.2 Performance of Exchange Rate Reforms

should improve the competitiveness of the exports of these countries within the region. Market determined exchange rates should also remove incentives to smuggle and trade mis-invoicing and therefore improve the accuracy of recorded trade.

Relaxation of import controls has been successfully implemented in all the countries except Ethiopia (Table 4.3). The future implementation of the reforms in Rwanda is also poor. The poor performance of the reforms in Ethiopia is understandable given that the reforms were initiated in 1992. Most countries now have an OGL system with a short negative list. The implementation of this reform is very significant because it is normally the most pervasive trade policy. Removal of quantitative restrictions is one of the most effective ways of increasing cross-border trade in the region.

It is also evident that most countries have implemented or designed appropriate export promotion policies (Table 4.4). The exception is Rwanda where current and future reforms have been poorly articulated. The export promotion policies have been in the form of duty drawback schemes, export retention schemes, reduction or removal of export taxes, abolition of export licensing, and promotion of nontradi-

Table 4.3 Performance of Import Control Reforms

Table 4.4 Performance of Export Promotion Policies

tional exports. These policies should increase intra-regional trade by improving the competitiveness of the region's exports and by creating a conducive environment for trade. The policies should also reduce incentives for illegal trade thereby increasing recorded trade. Efficiency in production and reduction in illegal trade will lower prices thus improving consumer welfare.

INTRA - REGIONAL TRADE

Table 4.5 shows that recorded export trade among the East African Countries is very low. According to published accounts these countries mostly trade with industrial countries with only Kenya and Rwanda having a relatively large share of exports going to African markets. In 1991 the share of total exports of each of these countries, except Kenya, to the region was less than 3 percent. For example, Ethiopia's exports to the region was less than 0.5 percent of its total exports while Kenya's exports to the region, at about 13 percent, was the highest.

Table 4.6 shows that recorded imports from the region are also very low. Ethiopia, Uganda and Tanzania obtain their imports exclusively from Kenya. Imports from the region by all the countries except Uganda and Rwanda, make up less than 5 percent of their total imports. Rwanda and Uganda import about 18 and 23 percent of their total imports from Kenya, respectively.

The data presented in Tables 4.5 and 4.6 only represent recorded trade flows. It is widely felt that unrecorded trade among the East African Countries is likely to be substantial and is quite vital to the region. The tables show that Uganda does not trade with Tanzania and that Burundi does not trade with Uganda and Tanzania. This is highly unlikely. The absence of recorded trade among these countries could be explained by the existence of informal cross-border trade.

The trade policy effects on recorded trade can be illustrated using data in Tables 4.5 and 4.6. For example, Table 4.5 shows Kenya's exports to the region. These are also recorded in Table 4.6 as imports by the other countries from Kenya. One would expect exports to a country as recorded in Kenya to be equal to imports from Kenya by that country. Although there will be a small difference in published data arising from the fact that imports are valued CIF while exports are valued f.o.b., this difference can easily be calculated and netted out using published CIF data. However, if the difference still exists after the adjustment then the size of difference represents trade mis-invoicing.

As an example Kenya's trade with other countries is used to estimate the level of mis-invoicing of imports. Table 4.7 shows Kenya's imports from the other countries and exports by those countries to Kenya. The imports have been adjusted for c.i.f. using a weight of 16 percent obtained from IMF, International Finance Statistics. The weight indicates that cost insurance and freight make up 16 percent of the value of Kenya's imports. The extent of import mis-voicing in Kenya is shown in Table 4.7 as the difference between exports and adjusted imports as a percentage of the adjusted imports.

Table 4.5 Regional Exports Matrix, 1991 (Millions of U.S.$)

Table 4.6 Regional Imports Matrix, 1991 (Millions of U.S.$)

Table 4.7 Mis-Invoicing of Imports in Kenya, 1991, (Millions of U.S.$)

It is evident that in all the cases, except for imports from Uganda, there is an over-invoicing of imports. Imports from Burundi and Rwanda are over-invoiced by about 100 percent. This is generally done as a means of remitting capital abroad as a result of exchange controls. Imports from Uganda are under-invoiced by about 13 percent. Kenya's Imports from Uganda are low relative to those from the other countries, therefore, Kenya's imports from the region as reported in official documents are generally overstated. The problem is likely to be linked to trade policy distortions and should be reduced by the recent trade policy reforms.

REGIONAL AGREEMENTS IN EASTERN AFRICA

Introduction

The countries covered in this study belong to various regional integration groupings. All the countries belong to the Preferential Trade area for Eastern and Southern Africa (PTA). Rwanda and Burundi, with Zaire, also belong to the Economic Community of the Great Lakes Countries (CEPGL) and Kenya, Uganda and Tanzania have agreed to revive economic cooperation amongst themselves.

Regional integration schemes in Eastern Africa have not been successful in the past. However, the countries have not been deterred from participating in them. The desire for greater cooperation has indeed increased in recent years with the expectation that it would lead to greater prosperity in the region. A brief review of experience in economic cooperation in Eastern Africa follows. The objectives of the integration schemes, reasons behind past failures and future prospects are summarized.

Economic Community of the Great Lakes countries

The CEPGL was established in 1976 primarily as a means of maintaining closer cooperation between former Belgian colonies. The objectives of CEPGL were confined to trade liberalization, factor mobility and development of joint development projects. None of these objectives has been achieved. The movement of labor in the union is restricted and there has been little trade liberalization. This is because economies of the union are not competitive and little progress in trade liberalization.

Poor economic performance and disparity in economic performance among the member states have contributed to the failure of the union. Serious political problems in recent years have also disrupted economic activities in the union. These problems are deep making the success of CEPGL doubtful.

East African Community

The origins of the East African Community (EAC) go back to 1919 when it was established as a currency board. It was reconstituted into the East African High commission in 1948 with legislative and administrative mandate to coordinate policies and activities in the whole of East Africa on behalf of the British Government. The Commission, renamed the East African Common Services Organization in 1961, was reorganized and given a wider mandate.

EAC was formed with the objective of promoting cooperation in many areas. At its height it had a common external tariff, harmonized taxes, a monetary union and common services including railways, ports, telecommunications, Universities and research centers. Movement of labor within the union was relatively unrestricted.

Safeguards were incorporated into the 1967 treaty to avoid polarization in the union over the distribution of benefits which had been a problem since 1961. These included the introduction of the transfer tax system, the establishment of the East African Development Bank (EADB) and the distribution of the common services among the East African Countries.

The transfer taxes were imposed by deficit countries on manufactures from surplus countries. Initially Tanzania imposed tariffs on imports from Kenya and Uganda and Uganda imposed tariffs on imports from Kenya. Kenya had a trade surplus with the other two countries and therefore could not impose any transfer taxes. EADB was established primarily to finance projects in Tanzania and Uganda. Only one quarter of the Banks resources were to be invested in Kenya. The common services, all initially based in Nairobi, were distributed among the other countries after the treaty.

Despite the safeguards the EAC collapsed in 1977 mainly as a result of the perception of unequal distribution of benefits of the Union. Kenya's consistent trade surplus with the other member countries together with the concentration of industries in Kenya was considered as a source of regional inequality. Deep political differences among the heads of government also contributed to the lack of goodwill to solve the problems which faced the union. It should be added, however, that most other areas of economic cooperation were functioning well. The regions recorded trade shares were 17 percent and 15 percent for exports and imports, respectively. These shares had declined to 9 percent and 5 percent in 1980 and 8 percent and 4 percent in 1991.

The collapse of the EAC in 1977 has conditioned the cautious approach to the new cooperation. The tripatriate accord of November, 1993 establishing East African cooperation has avoided the reactivation of the pre-1977 type integration. The accord emphasizes trade and industry, tourism, transport and communication, agriculture, science and research as the key areas of cooperation. Free movement of people, goods and services and capital was to be allowed among the countries by early 1994. Deeper cooperation has, however, been left to evolve gradually.

The Preferential Trade Area for Eastern and Southern African Countries

The PTA* was established in 1981 with the purpose of promoting trade in the region through tariff reduction and removal of non-tariff barriers. Trade liberalization was to culminate in a common market by 1992. The other areas of cooperation are in the fields of agriculture, industry, transport and communications. Movement of labor was to be encouraged through the relaxation of visa restrictions.

Very little progress has been made towards freer trade in the PTA. Trade liberalization is behind schedule and is now expected to be completed by the year 2000. The original schedule could not be met because of disagreements over the rules of origin, and

* The members of the group are Angola, Burundi, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Madagascar, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. Botswana, Eritrea, and South Africa (post-apartheid) are eligible to join.

the establishment of a compensatory scheme for those countries which would suffer revenue losses as a result of liberalization. Failure to liberalize trade has contributed to the low intra-PTA recorded trade. Lack of complementarity in production has also contributed to the low intra-regional trade.

There are however several areas in which cooperation among the PTA states has been successful. These include customs, immigration, trade, trade information and transport policies. A PTA clearing house was established as a means to reduce the use of foreign exchange in intra PTA trade. The amount of intra-PTA trade going through the clearing house has increased over time. A development bank has been established and is functioning.

The Common Market for Eastern and Southern African Countries

Although only a few of the goals of the PTA have been achieved a treaty transforming the PTA to a Common Market for Eastern and Southern Africa (COMESA) was signed in November, 1993. The treaty is to take effect as soon as it is ratified by eleven members countries. Under the treaty total elimination of trade barriers is to be effected by the year 2000.

The areas of cooperation under COMESA are: trade liberalization and customs cooperation including the establishment of a common external tariff and rules of origin, common bond guarantee scheme and trade documents and procedures; transport and communication; industry and energy; monetary and financial affairs; agriculture; and economic and social development.

The establishment of COMESA would seem to be premature given that very few objectives of PTA have been achieved. It is doubtful that COMESA will succeed where the PTA has failed especially since as a customs union it will have to carry out policies which are much harder to implement.

COMESA also faces a problem of divided loyalty among its members. It has become increasingly clear that the Southern African members of the PTA are more committed to Southern Africa Development Community than COMESA. The relaunching of East African Community will also dilute the commitment of the East African countries to COMESA.

Economic Cooperation under Unilateral Trade Liberalization

A regional Initiative on cross border trade was agreed upon in Kampala on August 1993 by the governments of the Eastern and Southern Africa countries (CEC, 1993a, 1993b). Burundi, Kenya, Rwanda, Tanzania and Uganda are signatories to this Initiative. The other countries are Malawi, Mauritius, Namibia, Zambia and Zimbabwe. The Initiative was jointly sponsored by the Commission for European Communities, Africa Development Bank, International Monetary Fund and the World Bank. The purpose of the Initiative is to facilitate increased cross-border investments, trade and payments in Eastern and Southern African and the Indian Ocean.

The Initiative emphasizes the role of unilateral trade liberalization (UTL), on the basis of existing structural adjustment programs, in promoting intra-regional trade. This means that each country is to liberalize trade on the basis of agreements with multilateral institutions. However each country will, as a minimum, be required to adhere to the agreed timetables for PTA trade liberalizations programs. The programs are to be implemented on a most-favored nation basis or on the basis of reciprocity where a transitional period is required.

Trade reforms to be implemented under the Initiative include: import liberalization in the form of lower tariffs (with total elimination by 1996) and the removal of all non-tariff barriers except a short "negative list" for security and health reasons; removal of all non-tariff barriers on exports except for a short negative list; and liberalization of trade in services such as financial services, insurance, transport, consultancy and tourism.

Under the payments and exchange liberalization, the participating countries are to: establish unified foreign exchange rates by 1996; eliminate restrictions on current account transactions; liberalize direct investment and investment in regional equity markets; and strengthen ongoing financial sector reforms or adopt the reforms for those countries without any. Apart from encouraging movement of capital within the region, the policy changes are primarily aimed at increasing intra-regional trade.

The analysis in the first section of this chapter indicates that most of these polices have been implemented. Tariffs in most countries have been reduced. These reforms are to be continued but it is doubtful that tariffs on intra-regional trade are likely to be totally eliminated by 1996. Non-tariff barriers to trade have been removed in most countries. Import licensing has been removed and in most countries OGL systems with short negative lists for health and security reasons installed.

Exports have been liberalized through reduction of elimination of export taxes and by abolition of export licensing except for a short negative list. Most countries now have flexible exchange rate regimes. Kenya, Uganda and Tanzania already have unified regimes. Ethiopia plans to unify rates before 1996.

Most countries in the region are currently trying to attract foreign investments. The reforms which have been introduced for this purpose are: simplification of industrial licensing, tax incentives and relaxation of profit repatriation and remittance regulations. Financial sector reforms have concentrated on interest rates and banking regulation. Interest rates have already been deregulated in Kenya and Uganda. The supervisory role of central banks has been improved in all the countries. Restructuring of commercial banks has been implemented in some countries. What remains to be done in most countries is to deepen the reforms.

Economic cooperation accompanied by the unilateral trade liberalization has several advantages over the traditional customs union. The most important is that it reduces conflicts among partner countries especially those conflicts arising from disputes about the distribution of benefits from the union. The countries, by independently carrying out trade liberalization, will move regional economies toward macroeconomic balance without coordinated macroeconomic policies. Under these circumstances, each country is responsible for the consequences of adjustment. The possibility of shifting blame for consequences of reforms is eliminated. This reduces disputes among countries participating in economic cooperation.

The other advantage of UTL is that it encourages increased intra-regional trade by increasing competition and therefore improving efficiency in production within the region. Increased efficiency will also improve the competitiveness of the region's goods in world markets thus promoting regional exports. Moreover, removal of quantitative restrictions and the movement towards convertible currencies will further increase recorded trade by removing incentives for smuggling. Regional cooperation in transport and communications, customs and other areas of trade facilitation will also promote intra-regional trade. Reduction of barriers on the movement of factors of production within the region will raise intra-regional trade by encouraging efficient resource allocation. By promoting macroeconomic stability, UTL improves the credibility of Government policies and therefore encourages investments in the region.

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